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# Supreme Court of the United States

October Term, 1942.

## No. 303

GUY T. HELVERING, Commissioner of Internal Revenue,
*Petitioner,*

v.

AMERICAN DENTAL COMPANY.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

## BRIEF FOR THE RESPONDENT.

John E. Hughes,
James A. O'Callaghan,
*Counsel for Respondent.*

U. S. Law Printing Co., Phone Lakeview 6581, Chicago, Illinois

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*May It Please the Court:*

A statement of the opinions below, jurisdiction and Statute and regulations involved is contained in petitioner's brief and not repeated here.

## Questions Presented.

This case presents the following questions. An answer to any one favorably to respondent will affirm the judgment below. (Except 5, which will affirm it in part.)

1. Was the forgiveness of interest and rent a gift within section 22 (b) (3) of the Internal Revenue Code? (Quoted on page 19 of petitioner's brief.)

2. If it was not a gift was there any forgiveness of the debt?

3. Did Congress, by section 22 (a) of the Internal Revenue Code intend to include forgiveness of debt in taxable income?

4. Was the forgiveness of rent and interest, if not a gift, a mere diminution of loss, being a reduction in the purchase price of property and thus not income under section 22 (a)?

5. Do the subsidiary findings of the Board as to the interest show it was forgiven in 1936 and as to rent, show it was forgiven in 1394 and thus override its ultimate finding that it was forgiven in 1937?

## STATEMENT.

The statement of the case on pages 2 to 5 of petitioner's brief is accepted.

Respondent argues the case from the standpoint of the rules announced by this court that a decision below may be affirmed on any ground appearing in the record, which shows it should be affirmed, although not considered by the court below. *Bondholders Committee v. Commissioner*, 315 U. S. 189, 192.

## Foreword.

On the subject cancellation of debt the decisions of the lower courts are in great confusion. (See statements to

this effect in articles cited in note 2 on page 8 of petitioner's brief.)

In their article in the Columbia Law Review, cited in note 2 on page 8 of petitioner's brief, Mr. Sugarman and Professor Warren say: "The developments in the courts and legislature have added confusion and chaos in a field of law which for many years had been in need of clarification." Note also statements to the same effect in the other articles cited.

The question is of vital importance to thousands of struggling debtors and to thousands whose debts were forgiven or partially forgiven, during the depression. As a result of the Federal Home Owners Loan Act and the various Farm Loan Acts, tens of thousands of mortgagors had their mortgage debts partially cancelled. Debts of thousands of others were wholly or partially forgiven apart from these Acts. Congress is now seriously considering the Ruml plan, which proposes the forgiveness of one year's taxes.

If one today owed \$1,000,000 and depended on future earnings to pay it he could probably never pay the debt. For one reason, because the federal tax on \$1,000,000 is \$899,500. If he lives in many states he would have a state income tax. If a resident of California, the two taxes total over \$1,000,000.

In his message vetoing the Walter-Logan bill the President referred to a tribunal "which looks forward to results rather than backward to precedent."

Looking forward, it is not rash to say there will some day be another great depression in this country. A decision, such as petitioner here seeks, will either loom as a plague to harassed debtors or be set aside by Congress.

The history of decisions on the forgiveness of debt may be briefly summarized as follows:

In earlier decisions the Board and the courts held generally that forgiveness of indebtedness did not result in income. A few are *Meyer Jewelry Co.*, 3 B. T. A. 1319; *Eastside Mfg. Co.*, 18 B. T. A. 461; *Progress Paper Co.*, 20 B. T. A. 234. A number of cases are collected in *Towers & Sullivan Mfg. Co.*, 25 B. T. A. 922 at page 924, including *Commissioner* v. *Simmons Gin. Co.*, 42 F. (2d) 327 (C. C. A. 10th) and *Burnet* v. *Campbell*, 50 F. (2d) 487 (App. D. C.). See especially *Dallas Transfer Co.* v. *Commissioner*, 70 F. (2d) 95 (C. C. A. 5th). The Board in its opinion in that case pointed out that after the forgiveness the taxpayer was solvent. See 27 B. T. A. 651 at page 657. This doctrine was departed from due to a misunderstanding of the decision of this court in the *Kirby Lumber Co.* case and what is believed to be an unwarranted extension of that decision by the Board. (Note comment on *Kirby* case in 53 Harvard Law Review, 977.)

This court's decisions in *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, and *Helvering* v. *American Chicle Co.*, 291 U. S. 426 (both set aside by section 114 of the Revenue Act of 1942) were made on a very narrow state of facts (to which they should be confined) and did not warrant the broad implications given them by lower courts. The following were the facts stated in *United States* v. *Kirby Lumber Co.*, 284 U. S. at page 2:

> "In July, 1923, the plaintiff, Kirby Lumber Company, issued its own bonds for $12,126,800 for which it received their par value. Later, *in the same year*, it purchased in the open market some of the same bonds at less than par, the difference in price being $137,521.80. The question is whether this difference is taxable gain or income of the plaintiff for the year 1923."

Of course, the court held it was income. It was a clear profit from dealing in property. Taxpayer actually received the profit in cash in the same year it bought and sold the property and the Treasury regulations in force for years expressly covered the situation. In the case at bar taxpayer received no cash or anything of exchangeable value and such Treasury regulations as there have ever been, referring to the situation, favor taxpayer. Also the bonds in the *Kirby* case were a mortgage on the property which was freed therefrom. Here the debts were not a lien on property.

The *American Chicle Co.* case was a case of bonds bought for less than the price for which they were issued. However, this court cautiously said in its opinion (291 U. S. at page 428):

> "The meagre stipulated facts present only a narrow point to which our decision must be limited."

## SUMMARY OF ARGUMENT.

When Congress used the word "gift" in section 22 (b) (3) of the Revenue Act of 1936 it had a well settled judicial meaning uniform for over a hundred years. Congress is presumed to have used it in this meaning. *United States* v. *Merriam*, 263 U. S. 187. The judicial definition of "gift" is the same as that given by Blackstone and Kent and the dictionary. It is:

> "A voluntary transfer of property by one to another, without any consideration or compensation therefor." (Law of Federal Income Taxation, Paul & Mertens, Vol. 1, sec. 6.05, page 151 and cases cited at pages 12 to 14 hereof.)

It is not disputed in petitioner's brief that the forgiveness in the case at bar was voluntary and without con-

sideration. Hence it falls squarely within the definition of "gift".

Petitions seeks to have this court add to the definition a hazy and nebulous requirement which he calls "donative intent." If he succeeds it will backfire on him in the gift tax cases. Donative intent is merely another way of saying that the transfer must be voluntary and with intent to vest the subject of the gift in the donee and that there must be no consideration. An analysis of the cases using the term will reveal they either turned on the question whether there had been a constructive delivery (and hence intent to transfer the property) or the transfer was by a corporation to one of its officers and on its face might have been compensation for services. In other words, was there consideration? Hence it was there necessary to decide whether it was intended as compensation or as a gift. Neither of these situations is now at bar. None of the elements of the above quoted definition of gift are disputed by petitioner's brief to exist here.

Also, for sixteen years, during which Congress repeatedly reenacted in identical terms the Statute here involved, the treasury regulations contained the regulation quoted by the court below (R. 49). The numerous reenactments of revenue acts while it was extant made it part of the Statute (see cases collected on page 11 hereof). Of course we would not make this point if any contrary regulation had ever been promulgated but none has. The regulation quoted on page 21 of petitioner's brief (it was not promulgated under the section of the Statute dealing with gifts) merely states cancellation of debt "*may*" result in the realization of income. "If for example" and it then gives three examples two of which are not cases of the forgiveness of debt but (1) of cancellation of debt as com-

pensation for services; (2) Income from sale and purchase of property, which two it says are income, and (3) a case of a shareholder's capital contribution, such as *Carroll McCreary Co.*, 124 F. (2d) 303 (C. C. A. 2nd), which it says is not income.

Omitted in petitioner's brief is the following statement in the regulation:

> "Income is not realized by a taxpayer by virtue of the discharge of his indebtedness as a result of an adjudication in bankruptcy, or by virtue of a composition agreement among his creditors, *if immediately thereafter taxpayer's liabilities exceed the value of his assets.*" (Italics Ours.)

It is submitted that the italicized portion of the regulation is absurd. The reason one goes through bankruptcy or makes a composition with creditors and the purpose of the bankruptcy law is to create solvency and if a bankrupt has a job or a penny he is always solvent after his discharge. Also, the only reason a creditor forgives a debt is to make the debtor solvent, otherwise he would be merely making a gift to his fellow creditors.

To say that a discharged bankrupt, made solvent by bankruptcy, has realized income from his discharge requires merely statement to disclose the absurdity of the principle petitioner would have this court lay down and the reasoning on which his argument rests.

However, if there was no "gift" in this case then no debt was forgiven and there can be no question of income. (See page 19 hereof.) All the cases cited by petitioner find a transfer of property based on a valuable consideration and thus outside the definition of "gift". So, if petitioner did prevail on the first ground respondent should prevail on this.

So far as section 22 (a) of the Revenue Act applies, here, it has been the same since income tax laws were enacted. It has been repeatedly construed by this court and Congress has repeatedly reenacted it between such constructions. The construction of the word "income" by this court was, by reenactment after these decisions, imported by Congress into the Statute. *Hecht* v. *Malley*, 265 U. S. 144, 153; *Burnet* v. *Harmel*, 287 U. S. 103, 108. In the decisions thus adopted by Congress this court defined income as "something of exchangeable value" and "a gain derived from capital, from labor or from both combined."[1] The regulations (Art. 22 (a)-1, Reg. 94) repeat and for years have repeated this definition. The forgiveness of debt in the case at bar was not derived from capital or labor nor was it anything of exchangeable value.

The forgiveness of the rent was a mere reduction in the purchase price of property which had depreciated in value below the amount agreed to be paid for it, due to the depression. It has been uniformly held such situation does not give rise to income (see page 20 hereof). Respondent never received anything for the interest.

No point can be made by petitioner of the fact that respondent deducted the rent and interest in prior years because it was stipulated respondent offered to pay the tax saved by these deductions but petitioner rejected the offer (R. 19). In this respect the case at bar differs from any in the books. Also section 3801 was designed to prevent the pyramiding of tax in one year due to prior year deductions, by making payable only the amount saved by such deductions. (See page 26 hereof.)

[1] Strattons Independence v. Howbert, 231 U. S. 399; Doyle v. Mitchell Brothers, 247 U. S. 179, and many other cases. See especially Bowers v. Kerbaugh Empire Co., 271 U. S. 170.

Finally, the subsidiary finding of the Board concerning the interest item overrides its ultimate finding because it shows the interest was forgiven prior to the year before the court and hence it could not be income in this year (See page 23 hereof). They also show the rent was forgiven "in April, 1934" (R. 38).

In *Burnet* v. *Sanford & Brooks*, 282 U. S. 359, at page 364 (cited on page 11 of petitioner's brief), this court distinguished *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170, by stating: Taxpayer "had neither made a profit on the transaction nor received any money or property which could be made subject to tax."

That is the situation at bar.

## I.

## The Forgiveness of Debt was a Gift Within the Meaning of Section 22 (b) (3) of the Internal Revenue Code.

Section 22 (b) of the I. R. C. reads:

> "(b) Exclusions from Gross Income.—The following items shall not be included in gross income and shall be exempt from taxation under this title:
>
> "(3) Gifts, Bequests, and Devices.—The value of property acquired by gift * * *."

Article 23(b)(3)-1 of Regulation 94, promulgated under the Revenue Act of 1936, like all other regulations under this section past and present, is the only regulation under this section and merely states:

> "Property received as a gift * * * is exempt from income tax."

The word "gift" is a word used in the Statute. Its meaning therefore is a question of law. If there were any

doubt about the interpretation of the word it would have to be resolved in favor of the taxpayer. *Hassett* v. *Welch*, 303 U. S. 303.

In using the word "gift" Congress meant to employ it in the ordinary and well settled meaning of the term. *Woolford Realty Co.* v. *Rose*, 286 U. S. 319, 327; *Old Colony Railroad Co.* v. *Commissioner*, 284 U. S. 552, 560. And where a word has an established judicial meaning, as "gift" had, Congress is presumed to have used it in that meaning (see quotation from this court on page ~~10~~ 16 hereof).

The applicability of the word "gift" to the transaction at bar is supported by dictionary definition, by a judicially approved treasury income tax regulation which existed unchanged for sixteen years (quoted in the opinion of the court below), by a present treasury gift tax regulation, by Congressional intent, and by the judicial definition of gift given in Blackstone and Kent and stated in innumerable and uniform decisions and as firmly established as anything can be in the law.

Webster's New International Dictionary (2d Ed.), defines a gift as "anything voluntarily transferred by one person to another without compensation." So do Blackstone and Kent, uniform Court decisions and state Codes.

Treasury regulations 45, promulgated under the 1918 Act; Regulations 62, under the 1921 Act; Regulations 65, under the 1924 Act; Regulations 69, under the 1926 Act; Regulations 74 under the 1928 Act and Regulations 77 under the 1932 Act, all contained the following, quoted by the court below (R. 49):

> "If, however, a creditor merely desires to benefit a debtor and without any consideration therefor can-

cels the debt, the amount of the debt is a gift from the creditor to the debtor, and need not be included in the latter's gross income.''

Since the promulgation of this regulation under the 1918 Act, Congress enacted five revenue acts and left the applicable Statute unchanged and the regulation was issued in identical terms under each of these revenue acts thereby bringing in operation the rule of legislative approval. *Brewster* v. *Gage*, 280 U. S. 327, 337; *Poe* v. *Seaborn*, 282 U. S. 101, 118; *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, 307; *McLaughlin* v. *Hershey Chocolate Co.*, 283 U. S. 488, 492; *United States* v. *Kirby Lumber Co.*, 284 U. S. 113; *Old Colony R. R. Co.* v. *Commissioner*, 284 U. S. 552, 557; *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299, 302, 307; *Massachusetts Mutual Life Insurance Co.* v. *United States*, 288 U. S. 269, 273; *United States* v. *Dakota, Montana Oil Co.*, 288 U. S. 459, 466; *Reinecke* v. *Smith*, 289 U. S. 172, 175; *Helvering* v. *Bliss*, 293 U. S. 144, 151; *Zellerbach Paper Co.* v. *Helvering*, 293 U. S. 172, 178, 180; *Old Mission Portland Cement Co.* v. *Helvering*, 293 U. S. 289, 293; *Hartley* v. *Commissioner*, 295 U. S. 216, 220; *McFeely* v. *Commissioner*, 296 U. S. 102, 108; *Morrisey* v. *Commissioner*, 296 U. S. 344, 355; *United States* v. *Safety Heating & Lighting Co.*, 297 U. S. 88, 95; *Lang* v. *Commissioner*, 304 U. S. 264, 270; *Helvering* v. *Winmill*, 305 U. S. 79, 83; *Morgan* v. *Commissioner*, 309 U. S. 79, 81. The Statute has never been changed. While the quoted words were not in the regulations issued under the 1934 Act, no contrary regulation has ever been promulgated and nothing published stating rescission therefrom. (The regulation quoted on page 21 of the government brief does not declare the contrary. It was not promulgated as a construction of section 22(b)(3) excluding gifts, but as a construction of 22(a). It gives three examples, two of which

are not examples of the forgiveness of debt. The third is and is declared non-taxable.

Since their promulgation, the regulations under the section of the Code imposing the Gift Tax have always stated and now state:

> "Thus for example a taxable transfer may be effected by * * * the forgiveness of a debt" (Art. 2; Reg. 79).

Article 1 of these regulations refers "to transfers of property without consideration which, in common law, are termed gifts."

Coming now to manifestations of Congressional intent the word "gift" is not defined in the Revenue Code nor in the income tax regulations, but both the reports of the House Ways & Means Committee and the Senate Finance Committee on the Revenue Act of 1932 (when the present gift tax was enacted) state:

> "The forgiveness or payment by A of B's indebtedness would constitute a gift to B." (72nd Congress, 1st Session, Senate Report No. 665, page 39; House Report No. 708, page 28.) (C. B. 1939-1, part 2, pages 477, 524.)

The above quoted dictionary definition of "gift" is found in 2 Blackstone 440 and 2 Kent 437. It obtains in New York where part of the interest was forgiven. See *Gray v. Barton*, 55 N. Y. 69 and in Illinois, where the balance of the debts were forgiven, *Berbacker's Estate*, 277 Ill. App. 201, 205, wherein the court says:

> "A gift, as defined by the authorities, is a voluntary transfer of property by one to another without any consideration or compensation therefor."

The income tax decisions in the federal courts have adopted it and defined "gift" as a "voluntary transfer of property from one to another without any consideration or compensation therefor." *Blair* v. *Rosseter*, 33 F. (2d) 286 (C. C. A. 9th); *Noel* v. *Parrott*, 15 F. (2d) 669, 671 (C. C. A. 4th). Instead as pointed out in *Bothin Real Estate Co.* v. *Commissioner*, 90 F. (2d) 91, 93, 94, state Codes enact this definition.

As the court below pointed out the transaction in the case at bar literally falls within it. Petitioner's case depends on enlarging the definition.

The court below disposed of the basis of the Tax Court's decision as follows (R. 50):

> "The Board states in its opinion: 'No evidence was introduced to show a donative intent on the part of any creditor. The evidence indicates, on the contrary, that the creditors acted for purely business reasons and did not forgive the debts for altruistic reasons or out of pure generosity. In none of the four instances was the forgiven a gift.'
>
> "Suppose the creditors did act for purely business reasons. As long as there was no consideration for the cancellation, the intent to give necessarily followed. Evidently the Board confused intent with motive. There is no evidence that the creditors did that which they did not intend to do. The creditors motives are immaterial. *South Dakota* v. *North Carolina*, 192 U. S. 286, 310."

Under the view of the Tax Court what is a taxpayer to do? Add technical farce to the trial by calling the creditor to ask him if he intended to do what he did? There is a firmly established presumption of law that one is presumed to intend the natural consequences of his acts. *Allen* v. *United States*, 164 U. S. 492. "Intent is the purpose to use a particular means to effect a certain result.

Motive is the reason for doing it." *Baker* v. *State,* 120 Wis. 135. "Motive is the cause inducing action. Intent involves the will." *State* v. *Logan,* 344 Mo. 351.

In the *Bogardus* case (petitioner's brief, page 13) a corporation paid money to a man who had worked for it. Obviously on this state of facts the payment might have been one of two things—a gift or compensation for services. The question necessarily was which did the payer intend it to be? In other words was there consideration? In the case at bar the facts are plain and unlike that in the *Bogardus* case give rise to no such question. It is not contended there was consideration. Either the forgiveness was a gift or no forgiveness took place. (See page 19 hereof.)

*It is submitted that the motive of a gift, if it can ever be considered, can only be considered in deciding the questions* (1) *whether there was a transfer;* (2) *whether it was voluntary and* (3) *whether there was no consideration for it. If these three elements are present, as in the case at bar, then a gift has been made and the motive or reason for making it is utterly immaterial.*

The government did not dispute in the court below and it does not dispute in its present brief that the forgiveness of debt was voluntary and that it was without consideration. It thus falls squarely within and meets all the requirements of the definition of gift, which is:

> "Anything voluntarily transferred by one person to another without compensation."

This would end the case except that the petitioner seeks to inject into and add to the above uniform dictionary, judicial, text book and statutory definition of a gift (in Code states) a further, hazy and nebulous conception of

donative intent. (What does he mean by this anyway? Intent to benefit the debtor or does he inquire into motives?)

A consideration of the decisions will disclose that where courts have employed the phrase it has been either solely as another way of expressing the requirements that the transfer must be voluntary, in order to solve the question of constructive delivery or else it has been used in the cases where money was transferred to a corporation's employee and the question was solely whether the payment was intended as compensation for services or a gift (*i.e.* whether there was consideration) such as the *Borgardus* case, cited on page 13 of petitioner's brief, or the *Old Colony Trust Company* case cited on the same page, in which this court expressly pointed out there was consideration for the payment, saying (279 U. S. 716, 729, 730):

> "The taxes were paid upon a valuable consideration, namely, the services rendered by the employee and as part of the compensation therefor. We think therefore that the payment constituted income to the employee."

Had the payment there been, as here, a voluntary one and without consideration it certainly would have been a gift.

The same section of the Statute, which excludes gifts from income, also excludes legacies from income but this court has indicated a legacy is taxable income where it is compensation for services. *United States* v. *Merriam*, 263 U. S. 179, 186-7.

In that case the court also said at page 187:

"'The word 'bequest' having the judicially settled meaning which we have stated, we must presume it was used in that sense by Congress. *Kepner* v. *United States*, 195 U. S. 100, 124; *The Abbotsford*, 98 U. S. 440, 444.'"

Of course, the same reasoning applies to the word "gift". If "donative intent" means anything it merely means a voluntary intent to transfer property to another without consideration. Reasons for doing it are beside the point and immaterial, except as they cast light on whether there was a transfer or whether there was consideration. In *South Dakota* v. *North Carolina*, 192 U. S. 286, 310, this court said:

"But the motive with which a gift is made, whether good or bad does not affect its validity."

In *Moores*, 3 B. T. A. 301, (in which the reason or motives of the gift was to avoid income tax), the Tax Court said at page 304:

"In our opinion, however, the motives that impelled him to make the gift are immaterial."

As pointed out in *Moore* v. *Moore*, 237 Ill. App. 190, 194, the intent to give has been considered in gift cases only because it is involved in the question whether there has been delivery and acceptance (*i.e.*, a transfer) or whether there was consideration.

It may not be amiss to point out that the injection of a nebulous theory of donative intent into and its addition to the essentials of a gift will afford a fertile field for gift tax litigation by donors seeking to avoid a gift tax and backfire on respondent. In 51 Harvard Law Review, p. 50, Mr. Paul says: "What is controlling is the absence of obligation to make the gift: it is immaterial that the donor may receive incidental benefits."

The court below properly observed that the Board's statement "the creditors acted for purely business reasons and did not forgive the debts for altruistic reasons or out of pure generosity" was immaterial so long as the creditors did "forgive the debts". Many gifts, such as some campaign contributions are not made for altruistic reasons. If campaign contributions, induced by a donor's hope for an appointment, are not gifts they are income to the donee. The public salary of Senators from large states will not be enough to pay the tax on them. The famous Trojan horse is the classic example of a gift not so made. Many wedding presents, including some to Marshall Goering's bride, may also be cited. If one man who hated another gave him $100,000 so he could drink himself to death it would nevertheless be a gift and subject to gift tax. The Board thus reached its legal conclusion by mistaken reasoning and confusing intent and motive. It is common knowledge that gifts result from business relationships just as they result from social relationships. (Section 23(q) of the I. R. C. allows corporations to deduct the gifts therein specified.)

The argument made by petitioner here was made and rejected in *Carroll-McCreary Co.* v. *Commissioner*, 124 F. (2d) 303 (C. C. A. 2nd) in which the court said (page 305):

> "In our opinion the phrase 'gratuitously forgives the debt' means simply that no consideration is paid by the corporation for release of the debt."

That case distinguishes *Helvering* v. *Jane Holding Corporation*, 109 F. (2d) 933, cited by petitioner, by pointing out there was consideration in that case and also shows the cases, cited at pages 10 and 11 of petitioner's brief

inapplicable. (See also pages 27 to 29 hereof for comment on those prior deduction cases.)

If pages 14 and 15 of Petitioner's brief be construed as advancing the argument that the question whether the forgiveness was a gift was a pure question of fact, such argument is unsound.

In his response to taxpayer's petition for certiorari in the *Jane Holding Co.* case (cited on page 8 of petitioner's brief) this present petitioner said (page 7 thereof):

> "Whether under the findings of circumstantial or of evidentiary facts the cancellation of the debt was gratuitous was a question on which the court might properly substitute its own judgment for that of the Board. See *Helvering* v. *Tex Penn Co.*, 300 U. S. 481, 490, 491."

The precise point was decided in *Bogardus* v. *Commissioner*, 302 U. S. 34, in which this court, at page 39 said of the question whether the transaction was a gift:

> "This, as we recently have pointed out, is a conclusion of law or at least a determination of a mixed question of law and fact. It is to be distinguished from the findings of primary, evidential or circumstantial facts. It is subject to judicial review, and, on such review, the court may substitute its judgment for that of the Board. *Helvering* v. *Tex Penn Oil Co.*, 300 U. S. 481, 491. *Helvering* v. *Rankin*, 295 U. S. 123, 131."

The following cases, among others, apply this principle: *Deputy* v. *Dupont*, 308 U. S. 488, 499; *Magruder* v. *Washington, Baltimore & Annapolis Realty Co.*, 316 U. S. 69; *Helvering* v. *Price*, 309 U. S. 409; *United States* v. *Armature Rewinding Co.*, 124 F. (2d) 589, 591 (C. C. A. 8th).

## II.

**If the Forgiveness Was Not a Gift Then There Was No Effective Forgiveness of Debt and Consequently There Is No Question of Income in This Case.**

If these debts were legally transferred from its creditors to respondent it is axiomatic and indisputable they would have to be transferred either by gift or by contract based on valuation consideration. Otherwise they were not transferred and in such event no question of income arises and the decision below must be affirmed.

There are only two ways known to the law by which legal title to personal property can possibly be transferred in a situation such as here presented. One is by gift. The other is by contract based on a valuable consideration. The last is excluded by the facts found and there is no contention it exists. An examination of all court income tax cases, cited by petitioner, holding no gift took place will disclose they find a transfer based on valuable consideration. Hence they are not in point here.

As said in 33 Harvard Law Review at page 691:

> "A gratuitous parol forgiveness of a chose in action is not valid."

See also *Allen* v. *Witherow*, 110 U. S. 119.

In all the cases where the point has arisen the debtors had to sustain it as a gift and failing this it was held no forgiveness took place. *Levy* v. *Greenberg*, 261 Ill. App. 541, is in point on the rent item. It holds it a gift but *Pusatere* v. *Darnell*, 296 Ill. App. 525, 528 holds no gift and no transfer in analogous circumstances. See also *United States* v. *Bostwick*, 94 U. S. 53. ~~Such~~ as cases collected in Gifts, 24 Am. Jurisprudence, Secs. 11 and 12; also sec. 76, page 770, in which creditors in situations like the one at bar promised to forgive the debts and afterwards sued for them. Also Restatement of Contracts, Sec. 76(a), pages

83, 85. *Gleason* v. *McDonald,* 103 F. (2d) 837, 838, 839 (C. C. A. 6th). *Farmers Life Assoc.* v. *Caine,* 224 Ill. 599, 606.[3] *Janci* v. *Carney,* 287 Ill. 359, 366. The Statute of Limitations on a written promise is ten years in Illinois (ch. 83, sec. 17).

There is no contention that a consideration sufficient to sustain any transfer, other than by gift, exists in this case. The Board did not meet this question. If the transfer was not a gift, there was no transfer and consequently no question of 1937 income and the decision below must be affirmed.

## III.

## The Forgiveness of the Rent in This Case Was a Mere Reduction in the Purchase Price of Property, or Contract Renegotiation, and Did Not Give Rise to Taxable Income.

Where property has depreciated in value and the creditor, in recognition of this reduces its purchase price, no taxable income results. *Helvering* v. *A. L. Killian Co.,* 128 F. (2d) 433 (C. C. A. 8th); *Hirsch* v. *Commissioner,* 115 F. (2d) 656 (C. C. A. 7th); *Borin Co.* v. *Commissioner,* 117 F. (2d) 917; *Hextel* v. *Huston,* 28 F. Supp. 521.

Petitioner had purchased, by a lease, property, *i.e.,* the right to use floor space, for $15,200 a year. The court will take judicial notice of the depression and its effect on realty values. (See note in 81 L. Ed. 1103.) This shrinkage was such that in 1933, instead of being worth $15,200 this space was only worth $8,400, as shown by the rental in the new lease then made (R. 38). It had suffered this shrinkage in value in 1932 and 1933.

These facts bring squarely in operation the principle of the foregoing cases, as this court will immediately per-

ceive as soon as it reads them. See also *Bowers* v. *Kerbaugh Empire Co.*, 271 U. S. 170. A somewhat analogous situation is life dividends on a life insurance policy which are treated as a reduction of cost. On this ground, also, the decision below should be affirmed.

**The interest forgiveness did not result in taxable income because taxpayer never received anything of exchangeable or realizable value for this interest.**

The income tax rests wholly on the theory of ability to pay and the undistributed profits tax presupposes there is income to distribute. As the court below points out (R. 50), "of course, the taxpayer never received a nickel it could have distributed as dividends."

Moreover, taxpayer never received any property or any accession to its assets on account of this interest. Nor were its assets freed of any lien. There was nothing to pay tax out of. This brings the item within the statements in *Commissioner* v. *Rail Joint Stock Co.*, 61 F. (2d) 751, (C. C. A. 2nd) at page 751, that the money sought to be included in income must have at some time added something to taxpayer's assets. And, under *Phellis* v. *United States*, 257 U. S. 156, 169, this something should be of "exchangeable value." The court said in *The Rail Joint Stock Co.* case (pages 751, 752):

> "In other words, the consideration received for the obligation evidenced by the bonds as well as the consideration paid to satisfy that obligation must be looked to in order to determine whether gain or loss is realized when the transaction is closed."

**The forgiveness of debt was not income within Section 22 (a) even if it was not a gift and if the forgiveness was effected by some other legal method than gift.**

When Congress enacted section 22(a) of the 1936 Act (quoted on page 19 of petitioner's brief) it did so with

the definitions of income, made by this court, in mind. Indeed, section 22(a), so far as applicable here, was a reenactment in identical terms of the same section contained in all revenue acts since 1918.

This court repeatedly and uniformly construed the definition between the dates of its various reenactments by Congress. In *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, 519, it said the word had the same meaning in the income tax acts as that given it in decisions (under the excise tax) from 1909. It reaffirmed the definition in *Eisner* v. *Macomber* and prior decisions, as it has repeatedly done, and added:

> "In determining the definition of income thus arrived at, this court has consistently refused to enter into the refinements of lexicographers or economists, and has approved, in the definitions quoted, what it believed to be the commonly understood meaning of the term which must have been in the minds of the people when they adopted the 16th Amendment to the Constitution. (Citing cases.) Notwithstanding the full argument heard in this case and in the series of cases now under consideration we continue entirely satisfied with that definition."

Compare *DeGanay* v. *Lederer*, 250 U. S. 376, 384.

The definition was repeated in *Goodrich* v. *Edwards*, 255 U. S. 527, 535.

The definitions given the word "income" by this court are repeated in *Hirsch* v. *Commissioner*, 115 F. (2d) 656, in which forgiveness of debt was held not to result in income and it was pointed out:

> "A transaction whereby nothing of exchangeable value comes in or is received by the taxpayer, does not give rise to or create taxable income," and prior decisions of courts below are examined.

See requirement of "exchangeable value" in *United States v. Phellis*, 257 U. S. 156, 169.

The income tax regulations under 22(a) now and for over twenty-two years have defined income as "a gain derived from capital or labor or from both combined."

The forgiveness of debt in the case at bar was not a gain derived from labor or from capital. It was therefor not taxable under section 22(a). See *Bowers v. Kerbaugh Empire Co.*, 271 U. S. 170. It is hardly arguable that Congress would adopt a law defining forgiveness of debt to be income or that those adopting the 16th Amendment so intended.

In *Edwards v. Cuba Railroad Co.*, 268 U. S. 628, government subsidies were held not income under section 22(a).

**The subsidiary findings of fact made by the Board override its ultimate findings and show the interest was forgiven in 1936 and the rent in 1934.**

The only year here involved is 1937. If the forgiveness took place prior to that year it could not be 1937 income and the decision below must be affirmed.

The ultimate finding of the Board is that it took place in 1937 but this cannot stand because it is clearly contradicted by the subsidiary, circumstantial and special facts found by the Board.

In *United States v. Esnault-Pelterie*, 303 U. S. 26, it is said at page 31:

> "We may, of course, inquire whether the subordinate or circumstantial findings made by the court below necessarily override its ultimate findings of fact

and show that the judgment in point of law is not sustainable."

In the same case on an earlier review (229 U. S. at page 206) it was said:

> "The special findings may not be aided by statements in the conclusions of law or the opinion of the court."

See also statement of this court in the *Bogardus* case quoted at page 18 hereof.

The findings, with regard to the interest, are specific and unquestionably show the interest was forgiven in 1936. They are as follows (R. 39):

> "The petitioner, in November, 1936, owed several creditors for merchandise which they had furnished the petitioner over a period of prior years. The petitioner had been a good customer of these creditors for many years. It had given its interest-bearing notes for the amount which it owed to each creditor. It went to three of these creditors in November, 1936 and asked for cancellation of interest on the notes on the ground that the creditors had made a similar arrangement with their other customers. Three creditors agreed that they would cancel all interest accruing after January 1, 1932."

If the finding may be aided by resort to the only evidence on which it could be based, the evidence shows the same thing (R. 13 to 15). There is no evidence of any conversation with the creditors or any act on their part in 1937.[2]

As to the rent the Board found (R. 38):

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[2] The fact that it was entered on the taxpayer's books in 1937 shows only that and nothing more. It is not evidence that the conversations forgiving it took place in 1937. The Board expressly found they took place in prior years.

"'The renting agent said he would make an adjustment and in April, 1934, advised the petitioner he would accept $7500 in payment of the back rent and would cancell the rest.''

This man died in July, 1934 (R. 21) so he couldn't have forgiven the rent in 1937. As pointed out in *United States* v. *Bostwick*, 94 U. S. 53, this rent reduction was not a contract. *Pusatere* v. *Darnell*, 296 Ill. App. 525, 528. See also opinion of court below (R. 49).

**Petitioner is not helped by the fact respondent deducted the rent and interest in prior years because respondent offered to make him whole and he rejected this offer. Also the object and purpose of Section 3801 of the I. R. C. is applicable.**

It was stipulated (R. 19) that respondent offered to pay petitioner the amount of tax it saved by the deductions in prior years and petitioner rejected the offer. He did so because he thought he could use the fact of the earlier deductions to collect much more tax from respondent than it saved by the deductions.

Taxation in a current year on account of items deducted in prior years is based on a principle akin to estoppel. There is no ground for an estoppel when one party offers to make the other whole, restore the *status quo* and save him from damage. The court below commented on "the unfairness of the government's position" (R. 50).

The argument of petitioner (Br. p. 17) that section 3801 is inapplicable rests on the misapprehension that what respondent offered to pay was the taxes for 1934 and 1936, based on the assumption that the forgiveness took place in those years. What respondent offered to pay was not this but the tax it saved by deducting the interest and rent (R. 19).

The committee reports show Congress knew a taxpayer might have saved little by deducting items in prior years but under the decisions cited on pages 10 and 11 of petitioner's brief might be taxed a large sum in a later year solely because of the earlier deductions, grossly disproportionate to the amount of tax saved by such deductions and wanted to prevent this in the future.

The Senate Finance Committee report on section 3801 states (see C. B. 1939-1, part 2, page 814):

> "This section of the bill provides an equitable solution of certain classes of income tax problems, now very numerous, which have caused much hardship to taxpayers, and great difficulty to the Commissioner, the Board of Tax Appeals and the Courts."

However, even if the case is not within paragraph (2) of section 3801 (quoted page 21 petitioner's brief) it is surely within the spirit and object of the section and since respondent, by offering to pay the tax saved by the deductions in prior years, thereby offered to do the same thing this section seeks to do, it is immaterial whether its case falls within it. The offer made it the same as if it did.

For any one of the reasons above stated and to do manifest justice the decision below should be affirmed.

All of which is respectfully submitted.

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# APPENDIX.

## Page to Page Analysis of Petitioner's Argument.

The court did not err in relying on Article 64 of Regulations 77 as urged at page 5 because this regulation states what would be a gift at common law. The word "gift" was used in the statute in its judicially accepted meaning and, this being so, no regulation could give it a gloss and none has tried to. It is not claimed the quoted regulation misstates the law.

The *Maryland Casualty Co.* case, cited on page 6, is not applicable. There *the cash on which it was taxed was actually received by taxpayer.* In the second place, it never offered to pay the tax saved by charging it to reserve.

There is nothing in the Board's findings of fact which states the cancellations "were made by the creditors in anticipation of commercial benefit with no intention to make a gift". Also, good will is often, and indeed nearly always, secured by gifts and gifts are often made to secure it. As stated by Randolph Paul in 51 Harvard Law Review at p. 50: "It is irrelevant that the donor may receive incidental benefits" and "what is controlling is the absence of obligation to make the gift."

None of the cases cited on page 7 are cases of forgiveness of debt. They were cases of profit from sale and purchase of property. Besides, the 1942 Act has set them aside. It would have been better for the country had they all been decided the other way.

As to the cases cited on page 8, the Board, in its opinion in the *Hadden* case pointed out taxpayer was liable as a guarantor for the debts of the corporation whose debts it forgave. This forgiveness prevented it having to pay them and this cash saving constituted consideration sufficient to support a contract. Also, it had deducted the debt in prior years but had not, as here, offered to pay the tax saved. The decision of the same circuit in *Dallas Transfer Co. v. Commissioner*, 70 F. (2d) 95, 96, indicates this is the distinction. There forgiven rent was held not income. The other cases are distinguished on page 6 of our brief in opposition.

As noted in note 9 on page 11 the *State Planters Bank* decision (which the Tax Court had refused to follow) was set aside by the 1942 Act.

All the cases cited in note 6 on page 10 and on page 11 are distinguishable from that at bar on four grounds. (1) There the taxpayers actually got the cash on which they were taxed; (2) They did not offer to pay the tax saved by deductions in prior years; (3) also none of them are cases of forgiveness of debt; and (4) none involve any possible gift.

On pages 12 and 11 petitioner dodges the question of defining a "gift". Once it is defined he is out of court for the facts here literally fit the definition. Absence of consideration is controlling where the transfer is voluntary. In the *Sportswear Hosiery Mills* case taxpayer had paid the processing tax to its vendor and when the vendor's liability to pay it to the government was enjoined and the tax subsequently held unconstitutional taxpayer was probably entitled to recover it from its vendor. At the time vendees were so claiming and many vendors thought so.

As above pointed out there was consideration in the *Hadden* case in the contractual sense.

The court below did not, as alleged at the bottom of page 13 of petitioner's brief, predicate "its decision exclusively on a finding of no consideration," as a reading of its opinion will show. It said the forgiveness was voluntary and the creditors intended to forgive the debt.

The argument at the bottom of page 14 and top of page 15 that the Board's conclusion of no gift is conclusive is answered at page 18 of this brief. Furthermore, the statement confuses the opinion of the Board with its findings of fact. There is no *fact finding* that a gift was not made or of intention either.

Answering page 16 it is pointed out on page 24 hereof that the subsidiary facts found contradict the finding of ultimate fact. The conclusion that the forgiveness occurred in 1937 cannot stand where it is overridden by the findings of subsidiary and circumstantial facts.

As pointed out on page 25 hereof, the petitioner on page 17 misapprehends taxpayer's offer.

The Board repeatedly referred to the transaction as "Forgiveness of Indebtedness" (R. 38) "forgiveness of interest" (R. 39). See also Opinion, R. 40.

The word "forgiveness" including as it does the word "give," implies a gift. As said in *Roe* v. *Roe*, 98 Fla. 840:

> "A debt may be the subject of a gift by the creditor to his debtor and is generally referred to as foregiveness of debt."